Macro Snapshot – Chief Economist Jean Ergas

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Markets are still coming to terms with UK events, with the only certainty further uncertainty. The primacy of politics remains unassailable and unpredictable – with nationalist emotions outweighing economic rationalism.

We see central banks as locked in a race with the populist "tsunami. People are fed up with the "old order" and want change now! Slowing global growth shall exacerbate inequality.

Storm craft warnings increase as we are now fighting a two front war – UK and the Italian banking system! Will Italy defy the EU – choice between the bad and the worse!

1-Today's action!

US taking its cue from Europe

The US looks like it shall be taking its cue from Europe, with S+P futures pointing downwards. Europe is slowly stirring following the central bank induced mirage last week – realizing that the UK political situation is far from solved and the potential for a "hard line" outcome is high.

UK – it is all about immigration!

We said from the start that the battle ground was not economics but immigration, immigration, immigration cloaked as sovereignty. Prior to the opening of the EU to the newly admitted countries of Eastern Europe – the EU faceless bureaucrats were deemed an annoyance but not an existential threat.

Those who had most to lose from quitting the EU voted to go!

The UK economy shall be facing considerable challenges and number of vulnerable shall increase as a result of the uncertainty wrought by the referendum. These are those who in their largest numbers voted against the EU and the additional social protections that it afforded them.

We see this as veering on the optimistic and should the property sector take a punch, there could be "some unpleasantness".

Is Standard Life the canary in the coal mine?

Are we already seeing the unwinding of the UK property sector?
Standard Life has blocked redemptions from its 2.9 billion pound retail fund. The fund which invests in commercial properties has been hit by considerable redemptions. Considering that the fund holds 13 per cent in cash, this may be the tip of the iceberg.

Property market not yet at bottom!

Shall we be seeing a replay of 2008 when commercial property fell by 40 per cent? In one week, we have read of 20 per cent discounts on property – the bottom is some ways off. The pressure on the banks shall intensify and we reiterate our fears as to the non-bank niche lenders.

Legal and General down 7 per cent – are the insurers next?

We are also seeing pressure build on the insurers, who derive a substantial part of their income from commercial property. Already hammered by collapsing bond yields – shall we be seeing government intervention to prop them up?

London commercial property – is it still a "store of value"?

A key consideration is that London commercial real estate was viewed by foreign institutional investors as a "store of value" – when the properties are assessed on a conventional yield basis, the results may look somewhat different.

UK construction index at lowest level in seven years!

We also saw that the construction index prior to the vote had fallen to the lowest level in seven years – reflecting that the mere possibility of a "leave" victory was sufficient to sow panic. This was accompanied by collapsing business confidence, with most predicting a contraction in the economy.

Sterling trading at a 31 year low to US Dollar – shall go lower

In the light of the above, it is not surprising that sterling is trading at a 31 year low. This despite the manifold protestations by the "leave" campaign that everything is just fine! Housing construction had already started to collapse before the vote – with the property builders having a better sense of the literally "facts on the ground" than Cameron.

The one blessing in disguise is that the UK is no longer on either the gold standard or part of a monetary mechanism. The entity of the recent move would have smashed through its reserves.

UK central bank reduces reserve requirements – shall have little impact on "real economy"

The Bank of England has reduced capital requirements for the banks. This is generally seen as the counsel of despair – with the aim of limiting the curtailment of credit to be expected in a downturn. We see this as having a limited impact on the real economy as uncertainty as to the future structure shall reign for some time.

Foreign investors shall be wary of political uncertainty and of a rapidly depreciating currency

Foreign direct investors while maybe not proceeding to a mass asset liquidation – which would now be at fire sale prices – shall be remiss to increase their stakes. On a more prosaic note – we may ask whether short term investors shall be willing to funnel excess cash into a rapidly depreciating currency.

Italian banks – we are starting to see the "Great Unwind"

Markets are also being impacted by the continuing drama of the Italian banks – with the EU challenging Italy's determination to bypass new rules and stage a "state as entrepreneur" rescue. We reiterate our view that there is no easy way out. With bad debts at 17 per cent of GDP and likely to rise, Italy may simply have to go it alone.

The choice is reminiscent of TARP – between the bad and the worse. The experts have once again overestimated the willingness or ability of the private sector to seize "bargains"!

2 – What are the prospects? This week – may be exciting!

Will this week be a "return to fundamentals" or continued hope in the central banks?

This week we shall see whether the stocks markets shall succeed in maintaining their boisterous tone. Shall equity ebullience focused on large caps hinting at a new role for leading groups - safe haven assets – continue?

Is the UK signaling a shift towards safety in size?

The gap between the FTSE 100 and the FTSE 250 is instructive – with investors looking beyond the depreciation dividend and seeking safety in geographical diversification and sustainable cash flow.

Government debt markets playing a different tune!

In contrast, the government debt markets appear to be discounting a return to the "Great Deflation" of the 1930's – with grinding slow growth the "shape of things to come".

All of Swiss government debt is now in negative territory and the UK 10 year has hit a record low.

We have QE yields without QE – will this boost the economy?

In the US we have succeeded in having QE yields without QE – will this support domestic capital investment and consumption? Will central banks continue to lower rates – subordinating bank solvency to avoiding a deflationary re-leveraging of company balance sheets?

We are keen to hear what the Federal Reserve shall say about the UK situation

The key data point shall be the US employment data – seen in times of "business as usual" as the principal metric. As these are anything but – we are far more interested in statements by Federal Reserve officials with regard to the prospective impact of the UK situation on the global economy.

Markets will be gearing up for earnings – but politics still in "pole position"

Markets shall be starting to gear up for earnings. However, we see these as being subordinated to political events which have not yet begun to play out. Following the UK vote, we are now in uncharted territory on both the economic and political planes.
The UK vote has shattered an order deemed unshakeable as well as cherished beliefs in the implacable advance of "progress".

While economic policies are deemed to follow some basic paradigms politics has a well-deserved reputation for unpredictability. The result of the UK consultation highlights that "nation state" trumps global economy!

Are we at the start of the populist wave in Europe?

Will the UK vote lend steam to the populist sentiment running riot in Europe – rendering countries ungovernable as rejectionist parties make effective coalitions impossible? The recent Spanish elections have failed to produce a clear majority and the advance of the 5 star Movement in Italy does not bode well for reforms.

3-Global overview

Despite comments by Gove – "experts" not giving up! EU not NAFTA!

The UK situation continues to be the" Talk of the town" as the "experts" – much mocked by the "leave" campaign attempt to divine the future – if not necessarily – righteous path. We reiterate our view that this is not – as was often presented in the US – a re-negotiation of trade agreements.

This is the "Congress of Vienna" with open doors!

What we are seeing unfold before us is a "Congress of Vienna" with open doors. Power is rapidly moving from elected parliaments to direct democracy as the "discontented of globalization" seek to redress the excesses of a world run amok.

What can we read into the financial market bounce?

With regard to the impact of what is an extremely fluid situation – this has hitherto been viewed through the prism of traded financial assets. A collapse was followed by an equally speedy recovery of some of the lost ground – with however fixed income at odds with stocks.

Global growth continues to be weak – central banks between a rock and a hard place

We continue to see global growth prospects as weak – as constraints on fiscal policy prevent demand management from picking up the relay baton from monetary measures. These have reached the limits of their efficacy. Central banks shall need to choose between limiting long term damage to bank balance sheets and attempting to stop the deflationary onslaught.

Shall we see a US re-pivot to the "Old world"?

On a global political scale, the UK referendum has – together with the refugee crisis – contributed to shift the political focus to Europe. Previously the European challenge was seen as economic - the political stability is now being questioned. We expect that there shall be a re-pivot to the "Old world" with the bottom line being security.

US economy slowing but still growing

With regard to specific regions – we see the US economy as growing at a pace sufficient to avoid a recession but not fast enough to significantly lift wages and increase consumption.
We put little stock in arguments pointing to "tightness" in a labor market – which is now increasingly centered on temporary employment affording little stability and no bargaining power.

Federal Reserve likely to tread cautiously

The center piece remains the Federal Reserve. We see the US central bank as unlikely to move for fear of triggering a "mass of money" shift out of the emerging markets and worsening the position of countries with substantial current account deficits. Further discussions centered on domestic metrics are now moot.

Euro Zone growth rates continue to reflect wide divergences between economies

As regards the Euro Zone, we reiterate our view of a hitherto incipient recovery in the aggregate but with wide divergences between the key economies. Germany continues to power ahead while Italy continues to struggle and France stalls. We see the populist surge as impeding the longer term reforms necessary to power growth.

Do not see emerging markets as "natural" beneficiaries of turmoil in the UK

Turning to the emerging markets, we do not view them as "natural" beneficiaries of the turmoil in the UK. While some see investments exiting Europe and flowing to the EM space – beyond re-balancing from very underweight positions we do not see this as likely.

The EM space in Asia continues to be subject to the centrifugal forces of Chinese growth and / or commodity demand. We are continuing to see slowing industrial production in China and do not see a second commodity super cycle on the horizon.

Emerging Europe in the eye of the storm

As concerns emerging Europe – the former socialist republics –we see them as in the eye of the storm. The exit of the UK prospectively reduces the flow of financing from the EU and a slow Euro Zone growth impacts on their role as part of the European supply chain.

Continue to see oil market as oversupplied

We remain relatively cautious on oil prices and continue to see the market as both oversupplied and subject to the impact of slowing global growth. The context shall not be helped by the economic uncertainty triggered by the UK events.

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He is an Adjunct Assistant Professor at New York University's School of Professional Studies and an Adjunct Faculty member at Manhattanville College. In 2014 he received the award for teaching excellence from NYU School of Professional Studies.

He is fluent in English, French, German, Italian, Spanish and Portuguese. He also has a certificate in Arabic – from NYU School of Professional Studies.

His career has spanned the complete range of macro risk analysis - energy / commodities with ENI - Global Fortune 500 17 - leading global natural resources group, capital markets with Swiss Bank Corporation (now UBS) and insurance / reinsurance with the A.M.Best Company. Jean contributes regularly to international media commenting on key macro-economic issues.

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